American Federation of Labor and Congress of Industrial Organizations

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June 16, 2006

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Regulation B--Bank Compliance with Gramm-Leach-Bliley Act Broker Registration Requirements
File Number S7-26-04

Dear Ms. Morris:

I am writing on behalf of the AFL-CIO to oppose the banking industry's campaign to delay and obstruct the Securities and Exchange Commission's proposed Regulation B as it applies to Health Savings Accounts (HSAs). This long-delayed Regulation would implement the Gramm-Leach-Bliley Act, allowing banks to engage in certain securities activities without registering as a broker under the Securities Exchange Act of 1934. The banks seek to expand those exemptions to allow unlimited investment of HSAs in equities.[1] While the banks would reap substantial fees from investing HSAs in equities, consumers, who need their HSAs to pay for vital medical care whenever they need it, will lose their savings to fees and risky investments in equities.

Americans who rely on HSAs to pay for their medical care need safe, secure accounts that are readily available whenever they need care. As drafted, Regulation B would provide that protection by limiting bank sweeps of HSA deposit assets into equity or fixed-income mutual funds. To protect HSA holders, Regulation B would limit bank sweeps to no-load money market mutual funds. According to the American Bankers Association, banks need "to invest in assets that generate higher yields." Yet they object to any SEC effort to require banks investing funds to comply with the same suitablity standards that apply to broker-dealers investing in equities. Moreover, the fees for equities are nearly three times the fees for money market funds, according to the Investment Company Institute.

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1 American Bankers Association, Health Savings Council, "SEC Regulation B Will Adversely Impact Health Savings Accounts," http://www.aba.com/aba/hsa_gr.htm (accessed 6/8/2006).

The banks also object to Regulation B's prohibition on "taking investment orders from custodial account customers unless those customers have an investment portfolio of at least "$25 million." They seek to eliminate the $25 million threshold and claim Regulation B will require them to "build costly compliance systems to measure compensation received from trust and fiduciary accounts" that "will discourage banks from offering trust and fiduciary accounts to prospective HSA customers." They speciously argue that consumers need banks to invest their HSAs in equities to generate sufficient funds to pay for their medical care. The fact is consumers need the SEC to protect their HSAs so they are fully funded and available whenever they need medical care.

The American Bankers Association falsely maintains there is no need for the SEC to regulate their investing activity with Regulation B because the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) already regulate them. Two of the largest banks offering HSAs are not even regulated by the Federal Reserve Board. The UnitedHealth Group's Exante Bank and the Blue Cross and Blue Shield Association's BlueHealthcare Bank, are Industrial Loan Corporations (ILCs). A loophole in the Bank Holding Company Act exempts ILCs and their parent holding companies from Federal Reserve Board regulation. In fact, both Federal Reserve Chairman Ben Bernanke and former Chairman Alan Greenspan have asked Congress to close the ILC loophole in the Bank Holding Company Act. Both have cited the need for the consolidated supervisory requirements and activity restrictions that apply to the corporate owners of other types of insured banks under the Bank Holding Company Act. We have detailed these concerns in a recent letter on this matter to the FDIC, which is enclosed for your review. Also enclosed is Chairman Greenspan's January 20, 2006 letter on ILCs to Rep. Jim Leach.

While the AFL-CIO and leading researchers at the Commonwealth Fund and the Employee Benefit Research Institute have serious reservations about HSAs, the ability of account holders to pay their medical expenses will be jeopardized if the suitability requirements of Regulation B do not apply to banks offering HSAs. The very nature of an HSA--- savings account, coupled with a high deductible health insurance plan---demands investor protections. HSA holders must have immediate and secure access to their assets to meet any medical care need covered by the Medicare Modernization Act.

The SEC's stated objective to protect investors with full disclosure is particularly relevant to the needs of Americans who are being asked to rely upon HSAs as an alternative to employer-provided health insurance. Surely the SEC must do all that it can to protect HSA holders, whose investments are their only means of health security for themselves and their families.

Sincerely,

Richard L. Trumka

RLT/mg
Enclosures

cc: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Annette L. Nazareth
Robert Colby, Acting Director, Division of Market Regulation

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

January 20, 2006

The Honorable James A. Leach
House of Representatives
Washington, D.C. 20515

Dear Congressman:

I am writing in response to your request for the Board's views on several questions relating to industrial loan companies (ILCs). ILCs are state-chartered, FDIC-insured banks that may be acquired by unregulated entities under a special exemption in federal law. This special exemption allows any type of company, including a commercial firm or foreign bank, to acquire an ILC in a handful of states (principally Utah, California and Nevada) and avoid the consolidated supervisory requirements and activity restrictions that apply to the corporate owners of other types of insured banks under the federal Bank Holding Company Act.

When this exemption was adopted in 1987, ILCs were mostly small, locally owned institutions that had only limited deposit-taking and lending powers. However, much has changed since 1987 and recent events and trends highlight the potential for this exemption to undermine important general policies established by Congress that govern the banking system and to create an unlevel competitive playing field among banking organizations. The total assets held by ILCs have grown by more than 3,500 percent between 1987 and 2004, and the aggregate amount of estimated insured deposits held by ILCs has increased by more than 500 percent just since 1999. Certain legislative proposals pending in Congress also would enhance the significance of the ILC exemption by giving ILCs the ability to open de novo branches across the nation and offer interest-bearing checking accounts to business customers.

Importantly, while only a handful of states may continue to charter exempt ILCs, there is no limit on the number of new exempt ILCs that these states may charter in the future. In fact, because Congress has closed the so-called "nonbank bank" and unitary thrift loopholes, the ILC exemption is now the primary means by which commercial firms may control an FDIC-insured bank engaged in broad lending and deposit-taking activities and thereby breach the general separation of banking and commerce.

Your letter highlights the important public policies implicated by this exemption. Consolidated supervision of the parent company of an insured bank provides important protections to the subsidiary bank and the federal safety net that supports the bank. It complements, and is in addition to, supervision of the subsidiary bank by the bank's primary supervisor(s). For these reasons, Congress has required that the corporate

owners of full-service insured banks, and foreign banks seeking to acquire a bank in the United States, be subject to consolidated supervision. In 1999, Congress also reaffirmed the longstanding separation of banking and commerce. In addition, in the Gramm-Leach-Bliley Act, Congress specifically conditioned the ability of full-scope securities and insurance firms to acquire or control insured bank(s) on the requirement that the parent holding company ensure its subsidiary bank(s) remain well capitalized and well managed and maintain a "satisfactory" or better rating under the Community Reinvestment Act. The ILC exemption permits the corporate owners of ILCs to operate outside this prudential framework.

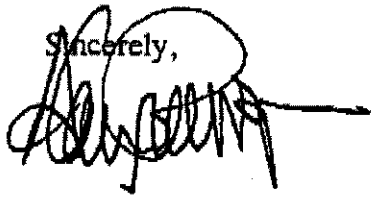
The Government Accountability Office (GAO) recently reviewed the growth of ILCs and the implications of continuing to allow these institutions to operate outside the prudential framework established for the corporate owners of other insured banks. The GAO report recommends that Congress consider eliminating or modifying the exemption that currently allows companies to own an FDIC-insured ILC without complying with the supervisory requirements and activity restrictions that apply to the corporate owners of other insured banks.

The character, powers and ownership of ILCs have changed materially since Congress first enacted the ILC exemption. These changes are undermining the prudential framework that Congress has carefully crafted and developed for the corporate owners of other full-service banks. Importantly, these changes also threaten to remove Congress' ability to determine the direction of our nation's financial system with regard to the mixing of banking and commerce and the appropriate framework of prudential supervision. These are crucial decisions that should be made in the public interest after full deliberation by the Congress; they should not be made through the expansion and exploitation of a loophole that is available to only one type of institution chartered in a handful of states.

For these reasons, I urge Congress to review the ILC exemption and the potential that it will further undermine the policies Congress has established to govern the banking system generally and create an unlevel competitive playing field among organizations that own a bank.

Responses to the specific questions posed in your letter are enclosed. I hope this information is helpful.

Sincerely,



Enclosure

1. Why were ILCs given their special status in federal banking law in 1987, and what has changed since the ILC loophole was created in 1987?

The federal Bank Holding Company Act (BHC Act), originally enacted in 1956, establishes a comprehensive prudential framework for the regulation and supervision of companies that own a bank (referred to as "bank holding companies"). This framework, which includes supervisory requirements and restrictions on the permissible activities of bank holding companies, is designed to help protect a bank from the risks posed by the activities or condition of its parent company (and the parent's nonbank subsidiaries) and maintain the general separation of banking and commerce in the American economy.

In the early 1980s, some commercial and other firms sought to evade the restrictions in the BHC Act by establishing FDIC-insured banks that performed some, but not all, of the functions necessary to be considered a "bank" for purposes of the BHC Act.[1] In 1987, Congress enacted the Competitive Equality Banking Act (CEBA) to close this so-called "nonbank bank" loophole and prevent further evasions of the BHC Act. In particular, CEBA expanded the definition of "bank" in the BHC Act to include: (1) any FDIC-insured bank (regardless of the activities it conducts); and (2) any banking institution that both offers transaction accounts and makes commercial loans (regardless of whether it is FDIC-insured).

At the time, Congress also adopted certain exceptions to this new and broad definition of "bank" for specific types of institutions, such as limited-purpose credit card banks and trust companies. However, restrictions were placed on these limited-purpose institutions to ensure that they could not operate as full-service banks. For example, exempt credit card banks were permitted to engage only in credit card operations and were prohibited from processing payments for affiliates or others.[2] Similarly, exempt trust companies were permitted to engage only in trust or fiduciary functions and were prohibited from obtaining payment or payment-related services from the Federal Reserve for themselves or other affiliated or unaffiliated entities.

A separate exception adopted in 1987 allows a company to acquire an industrial loan company (ILC) if the ILC is chartered in certain states (primarily Utah, California and Nevada). Although certain conditions were placed on an ILC operating under this exception, these limitations are less comprehensive and binding than the restrictions placed on exempt credit card banks or trust companies. For example, to retain its exemption, an ILC has the option of either keeping its total assets below $100 million or not accepting demand deposits that the depositor may withdraw by check or similar means for payment

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[1] At this time, an institution was considered a "bank" for BHC Act purposes only if the institution both accepted demand deposits and was engaged in the business of making commercial loans.

[2] See S. Rept. 100-19, 100th Cong., 1st Sess. at 30 (1987).

to third parties.[3] These limited restrictions, for example, permit an ILC--even one with more than $100 million in assets--to engage in the full range of commercial, mortgage, credit card and consumer lending activities; offer payment-related services, including Fedwire, automated clearing house (ACH) and check clearing services, to affiliated and unaffiliated persons; and accept time and savings deposits, including certificates of deposit (CDs), from any type of customer.

The legislative history to CEBA offers little explanation as to why the ILC exemption was adopted. This may be because in 1987 ILCs generally were small, locally owned institutions that had only limited deposit-taking and lending powers under state law. At that time, for example, the majority of ILCs had less than $50 million in assets and the largest ILC had assets of less than $400 million. Moreover, in 1987, the relevant states were not actively chartering new ILCs. Utah, for example, had a moratorium on the chartering of new ILCs at the time CEBA was enacted.

The landscape related to ILCs has changed significantly since 1987, a fact recently documented by the Government Accountability Office (GAO).[4] In 1997, for example, Utah lifted its moratorium on the chartering of new ILCs, allowed ILCs to call themselves "banks," and permitted ILCs to exercise virtually all of the powers of state-chartered commercial banks. In addition, Utah and certain other grandfathered states have since begun actively to charter new ILCs and promote ILCs as a method for companies to acquire a bank while avoiding the requirements of the BHC Act.

As a result, recently there has been a significant change in the number, size and nature of ILCs operating under the exemption. For example, since 1997 the number of Utah-chartered ILCs has more than doubled, and the aggregate amount of assets controlled by Utah-chartered ILCs now is more than *sixteen* times the aggregate total assets of all the banks, savings associations and credit unions chartered in that state.[5] In fact, one ILC operating under the exception now has more than $58 *billion* in assets and more than $50 *billion* in deposits. An additional seven exempt ILCs each have more than $1 billion in deposits. The aggregate amount of estimated insured deposits held by all ILCs has grown by more than 500 percent since 1999, and the total assets of all ILCs have grown by more than 3,500 percent from 1987 to 2004 (from $3.8 billion to $140 billion).

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[3] An ILC that was in existence in a grandfathered state on August 10, 1987, also may retain its exemption if it has not experienced a change in control since that date.

[4] See *Industrial Loan Companies: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority*, GAO-05-621 (Sept. 2005).

[5] All asset and deposit data are as of September 30, 2005, unless otherwise noted. Asset totals do not include credit card or other assets that have been securitized by an ILC or other institution and, thus, may understate the activities of an ILC or other institution.

Several large, internationally active commercial companies, including General Motors, General Electric, Pitney Bowes, BMW, Volkswagen and Volvo, also now own ILCs under this exception and use these banks to support various aspects of their global commercial operations. Wal-Mart, the nation's largest retailer, also has filed applications with the Utah Department of Financial Institutions and the Federal Deposit Insurance Corporation to acquire an FDIC-insured ILC.

In addition, while only a handful of states have the ability to charter exempt ILCs, there is no limit on the number of exempt ILCs these grandfathered states may charter in the future. Thus, there is no limit to the number of exempt ILCs that may be acquired or established in the future by companies that operate outside the prudential framework and activities limitations that Congress has established in the BHC Act.

2. Does the ILC loophole undermine the general policies that Congress has established for the financial system, including the policies of (i) maintaining the general separation of banking and commerce, (ii) requiring consolidated supervision of companies that own insured banks and foreign banks that seek to engage in the banking business in the United States, and (iii) allowing an organization to own a bank and engage in broad securities, insurance and other financial activities only if the organization complies with the capital, managerial and other criteria set forth in the GLB Act?

Yes. The United States has a tradition of maintaining the separation of banking and commerce. In the Gramm-Leach-Bliley Act (GLB Act) of 1999, Congress reaffirmed this policy by closing the unitary thrift loophole, which previously allowed commercial firms to control an FDIC-insured savings association, and by authorizing financial holding companies as a general matter to affiliate only with companies that are engaged in activities determined (by Congress or the Board, in consultation with the Treasury Department) to be financial in nature or incidental to financial activities.[6]

In the GLB Act, Congress also determined to allow a bank holding company to become a financial holding company, and thereby engage in a wide array of financial activities (including full-scope securities underwriting, insurance underwriting and merchant banking), only if all of the company's depository institution subsidiaries are and

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[6] Financial holding companies may, to a limited extent, engage in or affiliate with a company engaged in a nonfinancial activity if the Board determines that the activity is "complementary" to the company's financial activities and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. See 12 U.S.C. § 1843(k)(1)(B). Significantly, this limited exception was enacted in place, and after rejection, of provisions that would have authorized broader mixings of banking and commerce. See, e.g., H. Rept. 106-74, 106th Cong., 1st Sess., Part 1 at 10-11 (1999); H. Rept. 105-164, 105th Cong., 1st Sess., Part 1 at 13-14 (1997).

remain well capitalized and well managed. In addition, the Act prohibits a bank holding company from becoming a financial holding company, and a financial holding company from commencing any newly authorized financial activity, if any of the company's insured depository institution subsidiaries has less than a "satisfactory" record of performance under the Community Reinvestment Act (CRA). These supervisory requirements imposed on financial holding companies as a condition to their exercise of the newly authorized financial powers are stricter than those that ordinarily apply to insured banks.[7]

Since 1956, Congress also has required the corporate owners of full-service banks to be supervised on a consolidated basis. As discussed further below, consolidated supervision of the organizations that control banks not only helps prevent bank failures, it also provides important tools for managing and resolving bank failures if and when they do occur. In fact, following the collapse of Bank of Commerce and Credit International (BCCI), which lacked a single supervisor capable of monitoring its diverse and global activities, Congress amended the BHC Act in 1991 to require that foreign banks demonstrate that they are subject to comprehensive supervision on a consolidated basis prior to acquiring a bank in the United States.

Because ILCs are exempt from the definition of "bank" in the BHC Act, their corporate owners are not subject to these supervisory requirements and activity restrictions that Congress has established to govern the banking system generally. Accordingly, continued expansion or exploitation of the ILC exemption undermines the general policies that Congress has established concerning the mixing of banking and commerce, consolidated supervision of banking organizations operating in the United States, and the supervisory criteria applicable to diversified financial firms that seek to affiliate with an insured bank. The Board has on several occasions stated its belief that it is important for the Congress to decide, after a full and careful evaluation, the nation's policies in these areas, rather than allowing these policies to be decided for the Congress on a de facto basis through the exploitation or expansion of an exemption available only to one type of institution chartered in certain states.

3. Does the ILC loophole raise important questions of competitive equity?

Yes. As discussed above, companies that own an exempt ILC are not subject to the activity restrictions and supervisory requirements that apply to the corporate owners of other types of full-service insured banks under the BHC Act. This provides the corporate

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[7] The prompt corrective action provisions of the Federal Deposit Insurance Act, for example, generally are triggered only when an insured bank ceases to be at least "adequately capitalized." See 12 U.S.C. § 1831o. In addition, the CRA performance of an insured depository institution normally is not a factor that must be considered in determining whether the parent company of the institution may engage in, or acquire a company engaged in, nonbanking activities. See id. at §§ 2901 et seq.

owners of exempt ILCs a significant competitive advantage over the owners of other types of banking institutions and creates an unlevel competitive playing field among banking organizations. For example, the exemption permits:

* A manufacturing company, retail firm, or real estate brokerage firm to acquire an FDIC-insured bank *without* regard to the BHC Act's activity restrictions that are designed to maintain the general separation of banking and commerce;

* A securities or insurance firm to acquire an FDIC-insured bank *without* being obligated to keep the bank well capitalized and well managed or maintain the bank's CRA rating at "satisfactory" or better;

* A diversified financial or commercial firm to acquire an FDIC-insured bank and integrate the bank into its overall operations *without* being subject to the consolidated supervisory requirements that Congress has established to protect insured banks that operate within nonexempt corporate organizations; and

* A foreign bank to acquire an FDIC-insured bank that accepts retail deposits in the United States *even if* the foreign bank is *not* subject to comprehensive supervision on a consolidated basis by its home country supervisor.

The application of important public policies--such as those governing the proper mixing of banking and commerce and the role of consolidated supervision of banking organizations--should not depend on the location of a banking institution's charter or the particular nomenclature used to identify the institution. Rather, these policies should be decided by Congress after a full and careful evaluation and then applied to all organizations that own a bank in a competitively equitable manner.

4. What is consolidated supervision? How does it differ from supervision of a bank? Does consolidated supervision of a parent company add value in protecting the deposit insurance funds and the federal taxpayer from problems that may occur in an organization that owns a bank?

Consolidated supervision is a supervisory framework that provides a supervisor the tools it needs--such as reporting, examination, capital and enforcement authority--to understand, monitor and, when appropriate, restrain the risks associated with an organization's consolidated or group-wide activities. Consolidated supervision is a fundamental component of banking supervision in the United States and, increasingly, abroad. This is so because it provides important protection to the insured banks within the overall organization and the federal safety net that supports those banks. In addition, consolidated supervision aids in the detection and prevention of financial crises and, thus, mitigates the potential for systemic risk in the financial system.

Large organizations increasingly operate and manage their businesses on an integrated basis with little regard for the corporate boundaries that typically define the jurisdictions of supervisors. Risks that cross legal entities and that are managed on a consolidated basis cannot be monitored properly through supervision directed at any one, or even several, of the legal entity subdivisions within the overall organization. In order to fully understand and assess these risks, a supervisor must be able to analyze a business line on a consolidated basis across the organization, and then determine how the risks are transferred to and managed by the organization and its individual legal components.

This process is particularly crucial to understanding the risks to banks that are part of a larger organization. For example, an ILC or other bank owned by a large firm may be partially or entirely dependent upon affiliates for critical services, such as computer support, treasury operations, accounting, personnel, management and even premises. Moreover, banks that are part of a large organization sometimes have no business independent of the bank's affiliates. For example, the bank's loans and deposits may be derived or solicited largely through or from affiliates. In addition, activities conducted by the parent or its nonbank subsidiaries or a high degree of leverage at the parent company level may weaken the parent company's ability to assist its subsidiary bank in times of trouble. In these situations, it is particularly important that an agency have authority to examine the entire organization, address its capital strength, and enforce safe and sound policies and operations throughout the organization and across affiliates. Otherwise, problems at the parent company or its nonbank affiliates may spread to the insured bank or hamper the ability of the parent organization to serve as a source of strength for the bank.

The consolidated supervisory authority granted the Board in the BHC Act and other federal banking law provides the Board with both the ability to understand the financial strength and risks of the overall banking organization and the authority to address significant management, operational, capital and other deficiencies within the overall organization *before* these deficiencies pose a danger to a subsidiary insured bank and the federal safety net. The hallmarks of this supervisory framework are broad grants of authority to the Board to examine and obtain reports from bank holding companies and each of their subsidiaries, establish consolidated capital requirements for bank holding companies and take supervisory actions with respect to bank holding companies and their nonbank subsidiaries for unsafe or unsound practices or violations of law. Consolidated capital requirements are an important tool for helping to ensure that a parent organization is able to serve as a source of financial strength, not weakness, to its subsidiary insured depository institutions.

The Board's consolidated supervisory authority over bank holding companies complements, and is in addition to, the authority that the primary federal or state supervisors may have over the company's subsidiary depository institutions. Importantly, the Board's supervisory authority over bank holding companies and their nonbank subsidiaries exceeds in several key respects the supervisory authority that a federal banking

agency, acting in its capacity as a bank supervisor, may have with respect to the corporate parent or nonbank affiliates of an insured bank (such as an ILC).

For example, the BHC Act grants the Board broad authority to examine a bank holding company and its nonbank subsidiaries, whether or not the company or affiliate engages in transactions or has relationships with a depository institution subsidiary.[8] Pursuant to this authority, the Federal Reserve conducts examinations of all large, complex bank holding companies on a routine basis, which allows the Board to review the organization's systems for identifying and managing risk across the organization and its various legal entities and the overall financial strength of the organization.

In contrast, the appropriate federal banking agency for an insured bank, such as an ILC, is authorized to examine affiliates of the bank (other than subsidiaries of the bank) *only* to the extent necessary to disclose the relationship between the bank and the affiliate and the effect of the relationship on the bank. This examination authority, while important and valuable in supervising the insured bank, is significantly more limited than the authority granted the Board under the BHC Act.

In addition, the Board has broad authority to take enforcement action, including issuing cease and desist orders and imposing civil money penalties, against any bank holding company and any nonbank subsidiary of a bank holding company. This authority includes the ability to stop or prevent a bank holding company or nonbank subsidiary from engaging in an unsafe or unsound practice in connection with its own business operations. On the other hand, the appropriate federal banking agency for an insured bank has only limited authority to take enforcement actions against the corporate owner of an exempt bank and its nonbank subsidiaries; this authority can only be used if the owner or its nonbank subsidiaries engage in an unsafe or unsound practice *in conducting the business of the bank*. Thus, unsafe and unsound practices that weaken the corporate owner of an exempt bank, for example by significantly reducing the capital of the parent company, are generally beyond the scope of the enforcement authority of the appropriate federal banking agency for an insured bank.

The GAO recently reviewed the differences in the Board's authority over bank holding companies and the authority of the FDIC, as the primary federal supervisor of ILCs, over the holding companies of ILCs. As the GAO concluded, "[a]lthough the FDIC has supervisory authority over an insured ILC, it does not have the same authority to supervise ILC holding companies and affiliates as a consolidated supervisor." Moreover,

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[8] In the case of certain functionally regulated subsidiaries of bank holding companies, the BHC Act directs the Board to rely to the fullest extent possible on examinations of the subsidiary conducted by the functional regulator for the subsidiary, and requires the Board to make certain findings before conducting an independent examination of the functionally regulated subsidiary. 12 U.S.C. § 1844(c)(2)(B).

the GAO concluded that, as a result of these differences, "ILCs in a holding company structure may pose more risk of loss to the [Bank Insurance] Fund than other types of insured depository institutions in a holding company structure."[9]

5. Is it appropriate--as bills currently pending in Congress would do--to allow the corporate parents of ILCs to continue to operate outside the requirements and limitations of the BHC Act while at the same time granting ILCs the opportunity to offer NOW accounts to business customers or branch de novo nationwide?

No. Currently, there are two bills pending in Congress that would significantly expand the powers of exempt ILCs. The first, H.R. 3505 (the Financial Services Regulatory Relief Act of 2005), would allow exempt ILCs to open de novo branches throughout the United States. The second, H.R. 1224 (the Business Checking Freedom Act of 2005), would affirmatively authorize exempt ILCs to offer interest-bearing, checkable transaction accounts to business customers.[10]

The Board has opposed these expansions of ILC authority because they are inconsistent with the limited and historical functions of ILCs and the terms of their special exemption in current law. In addition, because these proposals would substantially increase the powers of exempt ILCs and the attractiveness of the ILC exemption, they would exacerbate the competitive advantage that the corporate owners of ILCs have over other banking organizations and further undermine the framework that Congress has established for the corporate owners of full-service banks.

For example, together these bills would allow domestic firms or foreign banks that are not subject to consolidated supervision--including consolidated capital, examination and reporting requirements--to own an FDIC-insured bank that has branches throughout the United States and has the ability to offer checkable transaction accounts to the full range of corporate and individual customers. Thus, these proposals would allow institutions that operate outside the prudential supervisory framework established by Congress to become, and operate as, the functional equivalent of full-service commercial banks. They also would allow a commercial or retail firm that owns an ILC to establish a branch of the ILC at any location across the United States despite the limitations established by Congress to maintain the general separation of banking and commerce.

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[9] See *Industrial Loan Companies: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority*, GAO-05-621 at p. 79 and 80 (Sept. 2005).

[10] H.R. 3505 was approved by the House Financial Services Committee in November 2005, but has not yet been taken to the House floor. H.R. 1224 was approved by the full House in July 2005. Importantly, the companion Senate bill (S. 1586) to H.R. 1224 would not authorize exempt ILCs to offer checkable accounts to business customers.

The limits contained in H.R. 3505 and H.R. 1224 do not adequately address these issue or the other important issues raised by the ILC exemption. For example, under H.R. 3505, even those ILCs established or acquired *after* October 1, 2003, could open interstate de novo branches unless an appropriate state supervisor for the ILC affirmatively determined that a company controlling the ILC derived more than 15 percent of its annual gross revenues from activities that are not "financial in nature or incidental to a financial activity." Similarly, H.R. 1224 would allow an ILC established or acquired *after* October 1, 2003, to offer checkable accounts to business customers if the ILC's chartering state determined that the companies controlling the ILC met this financial test. However, the bills do not tie this test to a federal definition of "financial activity" and, thus, allow states to be both expansive and inconsistent in their definition of what constitutes a "financial" activity.

The bills also would allow *any* ILC that received FDIC insurance before October 1, 2003, or had an application for deposit insurance pending on that date, to open de novo branches and offer checkable accounts to business customers nationwide so long as the institution does not experience a change in control. Thus, the bills would allow those commercial and retail firms that acquired an ILC before October 1, 2003, to transform the institution into a full-service retail bank and open branches of the bank across the nation.

The limits contained in H.R. 3505 and H.R. 1224 also do not address the other risks and issues presented by ILCs. For example, the bills fail to address the important issues associated with allowing domestic firms or foreign banks that are not subject to consolidated supervision to operate a full-service insured bank on a nationwide basis without federal supervision of the parent company or foreign bank. The bills also fail to address the competitive equity issues raised by enhancing an exemption that is available to only one type of financial institution that can only be chartered in a handful of states.

As the Board has testified, the Board does not oppose granting ILCs the ability to open de novo branches or offer checkable business accounts if the corporate owners of ILCs that exercise these expanded powers are covered by the same supervisory and regulatory framework that applies to the owners of other full-service insured banks. Stated simply, if ILCs want to benefit from expanded powers granted other insured banks, then they and their corporate parents should be subject to the same rules that apply to the owners of other full-service insured banks.

6. The bill that I have introduced would require the companies that own an ILC to comply with the same supervisory requirements and activity restrictions that apply to financial holding companies. Would enactment of this bill address the Board's concerns regarding ILCs?

The bill you have introduced, H.R. 3882, would subject the corporate owners of ILCs to the same prudential framework--including consolidated supervisory requirements,

bank-level capital, managerial and CRA criteria, enforcement mechanisms, and activity limitations--that apply to financial holding companies under the BHC Act and other federal banking laws. This approach would address the Board's concerns and ensure a fair and level competitive playing field for all banking organizations.

American Federation of Labor and Congress of Industrial Organizations

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April 26, 2006

Mr. John F. Carter, Regional Director
Federal Deposit Insurance Corporation
Suite 2300
25 South Jessie Street at Ecker Square
San Francisco, California 94105

Dear Mr. Carter:

I am writing to strongly urge the Federal Deposit Insurance Corporation (FDIC), pursuant to its authority under Sections 1815 and 1818 of the Federal Deposit Insurance Act ("the Act"), to protect the banking system and the health care of all Americans by holding hearings on the Blue Cross and Blue Shield Association's application for approval of a Utah industrial loan corporation (ILC) called the "Blue Healthcare Bank." In addition, I request a reconsideration of the FDIC's approval of the UnitedHealth Group's Exante Bank, also an ILC. Neither bank qualifies for Federal Deposit Insurance under the Act.

The Blue Cross and Blue Shield Association and the UnitedHealth Group created ILC's to take advantage of a dangerous loophole in the Bank Holding Company Act. This loophole enables an ILC to receive all of the benefits of bank insurance from the FDIC, while avoiding the necessary federal consolidated supervisory requirements and activity restrictions that apply to the corporate owners of other types of insured banks under the Bank Holding Company Act. Federal Reserve Board Chairman Ben Bernanke, his predecessor, Alan Greenspan, and the Government Accountability Office have all warned Congress of the dangers presented by the ILC loophole. The GAO has also described the limitations in the FDIC's authority to examine the corporate parent of an ILC and to take enforcement actions against ILC affiliates like the Blue Healthcare bank and the Exante Bank.

The FDIC's review of an application for Federal Deposit Insurance under Section 1815 of the Act is guided by the factors enumerated in Section 1816. Three of the seven critical factors spelled out in Section 1816 are:

> (4) The general character and fitness of the management of the depository institution.

(5) The risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund.

(6) The convenience and needs of the community to be served by such depository institution.

Section 1818 (a)(2)(ii) provides for the involuntary termination of insurance when the directors of the FDIC determine that "-- an insured depository institution is in an unsafe or unsound condition to continue operations as an insured institution."

Risks to the Bank Insurance Fund

The Blue Healthcare Bank and the Exante Bank both pose risks to the Bank Insurance Fund and neither bank serves the convenience and needs of Americans for comprehensive, affordable health insurance.

The health insurance market is inherently unstable. During the last decade, major health insurers, including state Blue Cross plans, Oxford (acquired by the UnitedHealthcare Group in 2004), Pacificare (acquired by the UnitedHealth Group in 2005) and Aetna have experienced serious financial difficulties. The UnitedHealth Group itself experienced financial difficulties during the 1980's. The only comprehensive regulation of health insurers is conducted by state insurance departments and they have limited resources.

Indeed, the primary purpose of the Blue Healthcare Bank and the Exante Bank is to capture sales and revenue that have, until recently, been the exclusive province of the health insurance companies. These ILC's are part and parcel of the insurance operations of their parent insurance holding companies. Their Health Savings Account deposits are assets that flow "straight out of the pockets of insurance companies, " according to Bank Marketing International (November 25, 2005).

Reliable estimates now show that 3 million Americans have established Health Savings Accounts. The White House projects that 14 million HAS's will be established by 2010, assuming Congress enacts the president's recent proposals. According to these estimates, the average individual's health savings account balance will grow from $1,500 in 2006 to about $3,500 in 2010. Even if depositors withdraw some or all of their health savings account deposits to pay their medical bills, HSA balances could reach $75 billion. Given the size of the health insurance market represented by the Blue Cross and Blue Shield Association and the UnitedHealth Group, their ILC's could well control almost $35 billion in deposits by 2010.

If the parent insurance holding companies of the Exante Bank or the Blue Healthcare Bank experience financial difficulties, nothing would prevent them from engaging in transactions that could jeopardize the solvency of their ILC banks. The Bank Insurance Fund itself would be

at risk. Lacking the consolidated supervisory powers of the Federal Reserve, the FDIC would be unable to examine and regulate the insurance operations of the UnitedHealth Group or the Blue Cross and Blue Shield Association.

The general character and fitness of management

The Securities and Exchange Commission and the Attorney General of Minnesota have recently commenced separate actions against the UnitedHealth Group's practice of awarding stock options to its CEO and senior management. According to *The Wall Street Journal*, the actions center on backdated options that have awarded the CEO of UnitedHealth Group options currently valued at $1.6 billion. UnitedHealth Group's share price has declined and the CEO has asked the Board of Directors to end such compensation for himself and senior management. As a wholly owned subsidiary of the UnitedHealth Group, the Exante Bank's management is directly accountable to the management of the UnitedHealth Group. At least two senior officers of the UnitedHealth Group were named as directors of the Exante Bank in its 2002 application to the FDIC: John K. Ellingboe, CEO, UnitedHealth Financial Services, Inc., and Kevin Pearson, CEO, Ingenix Health Intelligence.

The FDIC needs to review the character and fitness of the management of the Exante Bank in light of these significant developments.

The convenience and needs of the community to be served

More ominous, however, is the damage the Exante Bank and the Blue Healthcare Bank will do and are doing to the needs of all Americans for affordable, comprehensive health insurance. Their health savings accounts will increase, not reduce, the number of people who lack health insurance. According to MIT health economist Jonathan Gruber, 3.8 million previously uninsured people would gain health insurance coverage because of increased tax breaks for health savings accounts and a tax credit to help low-income people get HAS's. But 4.4 million people would become uninsured after losing employer-sponsored benefits—leading to a net loss of insurance for 600,000 people—and a net loss of business for insurers like Blue Cross and the UnitedHealthcare Group and a large increase in the number of Americans (45 million in 2005) without health insurance.

The FDIC must act to protect the banking system and the taxpayers. Granting Bank Insurance to Industrial Loan Corporations that are wholly owned and operated by health insurance companies poses a special risk to the FDIC and the taxpayers. The inherent instability of the health insurance market, the absence of federal regulation of health insurance and the inherent risks associated with Health Savings Accounts as an untested substitute for health insurance, require hearings and great caution. We urge the FDIC to deny the Blue Healthcare Bank application and to revoke its approval of the Exante Bank, or, as it has wisely done in the

case of the Wal-Mart ILC, to convene hearings as soon as possible on the Exante Bank and the Blue Healthcare Bank.

Sincerely,

John J. Sweeney
President

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